



A report by:
THE JOINT LEGISLATIVE STAFF
TASK FORCE ON GOVERNMENT OVERSIGHT

Prepared for:
ASSEMBLYMAN DENNIS CARDOZA
26TH ASSEMBLY DISTRICT

WHY PAY LESS... WHEN YOU CAN PAY MORE!

*Department of
General Services
eliminates automatic
discount buying
program.*



*A report of
findings and
recommendations
MAY 1998*

“In no other step of the government’s procurement process is the potential for saving millions of dollars more obvious than in the fast-pay discount offered by most vendors. We often wonder why more agencies don’t use this opportunity to save taxpayer dollars.”

– Testimony of Joseph Schaedel, National Federation of Independent Businesses, before the U.S. Senate Committee on Government Affairs, June 1987.

INTRODUCTION

Last fall, with little prior notification, the California Department of General Services (DGS) suddenly changed a decades-old policy designed to ensure that the state pays its bills on time. While the change in purchasing policy appears slight at first glance, its effect on the state's taxpayers and vendors is potentially enormous.

Considering the fact that the state spends roughly \$3.5 *billion* a year on goods and services, the fiscal impact of this policy change could easily exceed \$125 million.

In fact, once auto dealers complained that taxpayers could be forced to spend millions extra on vehicle purchases, General Services began quietly backing away from its decision and exempted vehicle purchases from its new policy. However, as of the date of this report, it is still in effect for nearly every other kind of purchase the state makes.

An investigation by the Joint Legislative Staff Task Force on Government Oversight has found:

- ❑ The purchasing change -- which eliminates prompt payment discounts from consideration in determining low bidders -- was made with little or no study, analysis or investigation. From the available records, it appears to have been done at the whim of a mid-level DGS official without any consultation with either vendors or state agencies. Once vendors began objecting, they were told that the policy was changed because the Department of Corrections was unable to pay its bills on time.
- ❑ The change will likely result in vendors having to wait even longer than they currently do to obtain payment from the state for goods and services, since there is no longer a built-in requirement for agencies to get the checks out promptly. Some state agency officials have also objected, arguing that the old policy was saving the state considerable money.
- ❑ Since the change effectively eliminates any financial penalty to the state if vendors don't get their money quickly, it is likely some vendors will raise their prices to make up for the additional costs incurred while waiting for payment. Two vendors interviewed by the Task Force said they intended to raise their prices as a result of the policy change.
- ❑ The suddenness of the change caused mass confusion among state agencies, purchasing agents and vendors, leading to several bid protests. In at least one case, it caused a longtime vendor to lose a state contract worth approximately \$750,000.

WHAT IS A PROMPT PAYMENT DISCOUNT?

A prompt payment discount is one of the few things in government that is truly a win-win situation. Simply put, it is a price-reduction companies offer to agencies that pay their bills quickly. It has long been a common practice in the private sector and for at least 20 years was standard purchasing policy in the state of California.

In concept, it works like this: Suppose the Department of Motor Vehicles contracts to buy 1,000 garbage cans from the XYZ Manufacturing Company for \$25 each. Once the cans are delivered, XYZ sends an invoice for \$25,000. However, if the bill is paid within 20 days, the Department is allowed to cut 5% off the invoice price (a discount commonly known as a “five-in-twenty.”) If DMV pays the bill before 20 days elapse, it would send the vendor a check for \$23,750. Thus, the taxpayers save \$1,250 and XYZ gets its money quickly, reducing its cost of doing business.

There is no set formula for figuring discounts. Both the percentage and the term can and do vary from vendor to vendor, and from commodity to commodity. For example, discounts on vehicles are for a fixed-dollar amount, normally \$500 per car, instead of a percentage of the total contract.

Until recently, when a business was bidding on a state contract, any prompt payment discount it offered was figured into the final calculations of the company's bid. Therefore, if the bid was accepted, the final price *included* the discount, under the assumption that the agency would pay the vendor in time to get the price break. Otherwise, the discount would be lost and the agency would be forced to pay a higher price for the product.

This arrangement, according to agency officials and vendors, gave an agency and its financial staff a compelling reason to make sure its invoices were paid on time -- it would have to expend additional funds if it did not -- and it appears that the policy was largely accomplishing its goal.

“I am not aware of any significant problems with earning the prompt payment discounts,” Department of Transportation official Martin Stevenson wrote DGS in November 1997 after learning of the policy change. Stevenson pointed out that “our warehouse aggressively earned over \$250,000 in discounts on a changeable message sign purchase order whose terms were 5% for payment in only three days” and he wondered why DGS was eliminating something that was saving such considerable sums.

“Is this a new overall policy? If it is a new policy, has there been some study or audit which prompted the change? Was there some change in legislation or new regulations that were promulgated?”

Tom Lee, DGS manager of Commodity Procurement, responded that “there is a lot of research and discussion over this policy change.”

But a review of DGS records shows that, while there may have been a lot of discussion, there was precious little research -- and all of it was done long after the decision was made to eliminate the discounts.

OUT OF THE BLUE

According to documents obtained by the Task Force under the California Open Records Act, the discount policy was changed in late April 1997 with the issuance of a single memo written by DGS official Mariel D. Edgeton, Manager of Disputes Resolution and Training. (attachment 1)

“Management,” Edgeton's memo announced, “has recently reconsidered the policy of using cash discounts to determine the bid price for evaluation and selection of the lowest bidder. Because the state may not be able to take advantage of discounts offered when payment occurs beyond the time for the discount, it is inappropriate to select the bidder by using the discount to adjust the bid price.” Her memo noted that agencies would still be free to accept discounts if the successful bidder offered them later and encouraged agencies to do so.

The import of this subtle policy change was that the state was no longer assuming agencies would be promptly paying their bills, and it was eliminating any built-in penalties for late payments. Henceforth, obtaining a discount and saving tax dollars would become an agency-to-agency option.

Edgeton's April 28, 1997 memo announced that the new policy would take effect in three days.

Apparently, the policy change produced such a storm of internal controversy that Edgeton was forced to write another memo on May 7, 1997, rescinding the policy “effective immediately,” so that DGS management could conduct “further deliberations.” (attachment 2)

DGS procurement official James Knibbe, who was involved in those deliberations, claimed not to know why such an abrupt reversal of policy had occurred, saying it was a decision made at a higher level.

At that point, it appears, DGS began an after-the-fact effort to justify the policy decision by conducting a brief telephone survey of other government purchasing departments. The results showed that the change was clearly out of step with surrounding states and county governments. Los Angeles, Orange, Santa Cruz, San Joaquin, Ventura, San Diego and Sacramento counties all reported that they used payment discounts in figuring their bid prices, as did the states of Arizona, Oregon, Utah and Washington. (attachment 3)

Task Force staff called four additional Western states - Nevada, Idaho, Montana and New Mexico - and were told by purchasing officials there that prompt payment discounts were not considered, but only because they knew their states had no hope of getting them due to antiquated billing and payment systems.

“We're just atrocious at paying our bills on time. We're notorious,” said New Mexico's purchasing director, Les French. French said that if his state upgrades its computer systems – as he is attempting to do – “of course we would consider it in our bidding process. It would be foolish not to. You could save a ton of money.”

In early August 1997, Patricia Jones, manager of the DGS Procurement Division's Systems Integrity Unit, expressed fears that the discount policy was being changed in a vacuum. “I can tell you that if we are proposing to NOT accept and evaluate such discounts, I don't believe we can discontinue our current practice until we have published our proposed practice, and give suppliers (and possibly others) an opportunity to voice their concerns,” Jones wrote. “So, it would seem that, for the time being, our current practice should continue.” (attachment 4) Another manager, DGS records show, “was concerned that we were dealing with regulations and not going through OAL” (the Office of Administrative Law, which reviews proposed regulatory changes).

Nonetheless, on August 15, 1997, top DGS purchasing officials held a staff meeting to discuss changing the discount policy. The change was justified by citing the fact that the federal government and several large states, such as New York, Florida and Texas, did not accept bids with prompt pay discounts. (A federal General Services Administration official, Patrick Connolly, told the Task Force that the federal government had factored discounts into bid calculations until the mid-1980s, when it discovered that some crude oil brokers were essentially playing a futures market and reaping windfalls by taking advantage of wildly fluctuating oil prices.)

According to notes of that August meeting, procurement division Deputy Director C.F. “Chuck” Grady decided: “Eliminate them! Need to communicate and get input before we implement.” A date of October 15, 1997, was set for implementation of the new policy, according to the meeting notes. (attachment 5)

Again, DGS embarked on another attempt to justify an already-made decision, sending out a memo (attachment 6) to a few select vendors and state agencies asking for opinions on the proposed change. The memo was hardly unbiased; most of it was devoted to an explanation of why it would be a good idea to eliminate the discounts “because they are predicated on future and uncertain actions.” (Presumably, those “uncertain actions” concerned the prompt payment of bills.)

DGS admits that the response to the survey was “minimal.” (attachment 7) Predictably, the few responses it received supported eliminating the discount. Some of the reasons cited in support of the change are illuminating.

“If a competition is close and the award is made based on the prompt payment discount, and subsequent events (paperwork not processed on time, cash-flow problems) render the Department unable to take advantage of the discount...the Department's integrity may become suspect,” wrote Mary Wandschneider, chief of the business services bureau of the Department of Youth Authority. (attachment 8)

On October 14, 1997, DGS procurement officers were notified that the Department had changed its policy and bid solicitations began going out with a small note on the front announcing that cash discounts would no longer be used in calculating the low bidder. (attachment 9)

THE VENDORS REVOLT

The first group of vendors to complain about the change was automobile dealers who, in late November, were shocked to discover that a bid solicitation for 200 used subcompacts declared it would not consider prompt payment discounts. Representatives from Downtown Ford, Maita Chevrolet, and Swift Chrysler Plymouth sent angry letters to Deputy Director Grady, pointing out that the change was going to cost taxpayers considerably more money.

“We have been involved with the State of California contracts for many years and have found that the cash discounts offered by bidders is a very fair procedure as it provides for prompt payment in many situations. It is a procedure to reduce cost to the state,” wrote Maita's fleet manager, Ron Brewer. Brewer warned that by eliminating the discount “we have to anticipate more...costs on these vehicles and will have to pass those costs onto you the purchaser.” (attachment 10)

Dave Forbess, Downtown Ford's fleet manager, estimated that if the policy had been in effect earlier in the year when the California Highway Patrol sought bids for 630 cruisers, “the state would have paid \$182,700 more for the same vehicles...Mr. Grady, you can play with the equations in a multitude of ways and come up with varying amounts. The bottom line is by allowing this new provision, the State and her taxpayers are ultimately paying more.” (attachment 11)

Charles O. Swift, owner of Swift Chrysler Plymouth, wrote that his company had already submitted several bids “based on the vehicles being paid in 20 days.” If the state was now planning to take 60 days to pay – as the new purchasing policy allowed – Swift was going to have to re-evaluate the situation. “It will certainly affect the price we quote to the state,” Swift wrote. “Mr. Grady, as a bidder and businessman, I do not understand at all the reason for this change in policy...” (attachment 12)

In addition to the car dealers, state agencies also began complaining. As mentioned above, Caltrans official Stevenson noted that for a \$2.1 million bid solicitation his agency was seeking “the impact of this change is significant...Five percent of \$2.1 million is \$105,000.” He warned that “by not including a prompt payment discount in the evaluation of offers, vendors who until now had offered a prompt payment discount of 5% would not have any reason to do so.”(attachment 13)

THE DEPARTMENT BACKTRACKS

Because of the auto dealers' pressure, a one-time exception was made for the used-car bid and discounts were allowed. DGS sent out another memo on December 11, 1997, modifying its October policy "in an effort to be responsive to our customer's requests." If an agency demanded in writing that a prompt payment discount be included in the bid, "an exception may be made for that transaction." (attachment 14)

But that one-time exception did not satisfy the auto dealers, who demanded a meeting with Grady and other DGS officials in an effort to get DGS to rescind the entire policy. That meeting occurred on February 20, 1998. In interviews with Task Force staff, all of the dealers who attended confirmed that when they pressed DGS for an explanation for the policy change, they were informed that the Department of Corrections had been behind it.

"We were told that the reason was that there was some corruption in Corrections, some food vendors were giving discounts that amounted to kickbacks going to Corrections officials," Forbess said. "I don't know if that's actually the case or not, but I do know that Corrections has always had difficulty paying its bills on time and they always seem to lose their discount."

Bill Kemmery, fleet manager for Lasher Dodge, said "the key reason we were given was that because Corrections, with its expansion, was having growing pains and had run into some problems and the agency was always paying \$500 late fees. They didn't want to have to keep paying late fees so the suggestion was made to get rid of the discounts. To me, the simpler solution would have been to fix whatever problems existed at Corrections -- not eliminate the discount."

DGS claims that no notes or minutes were kept of that meeting. When asked about the allegations involving the Department of Corrections, the DGS official assigned to speak to the Task Force, Patricia Jones, said, "It may be. I don't know."

Corrections officials said they had no knowledge of any allegations of kickbacks involving food vendors and disputed the assertion that the Department had requested DGS to change its prompt payment policy.

The dealers said they were told their concerns would be taken under advisement at DGS but no commitments were made. They were never formally notified of a decision but shortly afterwards, all bid solicitations DGS sent out for vehicles had reverted back to the previous policy regarding prompt payment discounts. Jones confirmed that because "the automobile industry is somewhat unique" DGS has made a blanket exception from the new policy for all vehicle purchases.

That, however, was little solace to Jim Guttridge, head of national fleet sales for Navistar International Transportation Corp., a manufacturer of heavy trucks. Guttridge said a bid he submitted in November for a half-dozen four-wheel drive plow trucks for Caltrans was rejected because he had included a prompt payment discount in his proposal. The value of the contract, Guttridge said, was approximately \$750,000. Guttridge said he appealed the rejection on the grounds that the policy change wasn't formally announced, but said his appeal was rejected "because

they had one sentence on the front of the solicitation...they've been accepting discounts for 20 some years and they changed the policy overnight and didn't tell anyone. In my opinion, they hid it.”

ADDITIONAL EXCEPTIONS MADE

In early January, Kevin Rockwood, the assistant director of Pharmacy at Napa State Hospital noticed the change when bids were solicited for the state's new Prime Vendor Contract for pharmaceuticals -- a contract worth an estimated \$165 million a year. Rockwood fired off a letter to DGS, arguing that the change would be a major setback to the state.

“As you are well aware, the State of California has had problems getting vendors to bid on the prime vendor contract because of our notoriously bad reputation for not paying our bills on time,” Rockwood wrote. “The primary incentive in improving our reputation for prompt payment was the cash discount you negotiated in the last prime vendor contract.” Rockwood noted that the discount provision had proven to accounting departments “how much money can be saved and most take full advantage of this. It would be a shame to lose these hard earned gains and ultimately end up paying more...” (attachment 15)

Dr. Nadim Khoury, assistant deputy director of the Department of Corrections' Health Care Services Division, also objected, writing that “this could adversely impact potential savings for the Department of Corrections and other agencies utilizing the Prime Vendor Contract for ordering drugs.” Khoury estimated the change could cost Corrections alone \$250,000 a year. (attachment 16)

DGS official Jones said the contract terms were changed after the complaints to permit the use of a discount.

CONCLUSIONS AND RECOMMENDATIONS

It is obvious from the foregoing that both vendors and agencies believe the old policy of using prompt payment discounts to evaluate bids was saving the state money and improving its reputation and performance for paying its bills on time. It is equally obvious that if the discounts are no longer considered, wary vendors will raise their bid prices accordingly to guard against lengthy delays in payment and taxpayers will end up paying higher prices for goods and services. Under the current policy, the inescapable conclusion is that saving tax dollars has been turned into an option for state agencies, and that there is no longer any real incentive for slow-paying agencies to improve turnaround time since the agency will have already agreed to pay the higher, non-discounted price.

Therefore, the Task Force recommends:

1. That the Department of General Services immediately rescind its current policy which allows the use of prompt payment discounts to be an agency-by-agency option.
2. That the Legislature require state agencies to report to either the Department of Finance or the Department of General Services on an annual basis all late payment penalties incurred by the agency during the previous 12 months due to a failure to take advantage of a prompt payment discount. Further, that all reports be forwarded to the appropriate budget subcommittees of the Legislature for review and that the budget committees consider automatically reducing the agency's annual budget request by a like amount.
3. That the State Auditor or Joint Legislative Audit Committee conduct a survey to determine which state agencies are incapable of paying vendors in time to take advantage of prompt payment discounts.

ATTACHMENTS

1. 4-28-97 memo from M. Edgeton.
2. 5-7-97 memo from M. Edgeton.
3. Results of DGS cash discount survey (3 pages).
4. E-mail from P. Jones to J. Gibson, 8-8-97.
5. Notes of DGS management meeting, 8-15-97.
6. DGS policy announcement, 8-97.
7. Open Records Act response from DGS to Task Force, 4-28-98.
8. Memo from M. Wandschneider 9-23-97.
9. DGS policy announcement, 10-97.
10. Letter to C.F. Grady from R. Brewer, 12-9-97.
11. Letter to C.F. Grady from D. Forbess, 12-5-97 (2 pages).
12. Letter to C.F. Grady from C. Swift, 12-11-97 (2 pages).
13. E-mail from M. Stevenson to T. Lee, 11-5-97 (2 pages).
14. DGS policy announcement, 12-11-97.
15. Letter from K. Rockwood to R. La Sala, 1-6-98.
16. Memo from N. Khoury to R. La Sala, 1-7-98.

STATE OF CALIFORNIA

STATE AND CONSUMER SERVICES AGENCY

Memorandum

DATE: April 28, 1997

TO: All Procurement Division Buying Personnel and Managers

FROM: Mariel D. Edgeton
Disputes Resolution and Training
Procurement Division
Department of General Services

SUBJECT: **BID EVALUATION AND USE OF CASH DISCOUNTS**

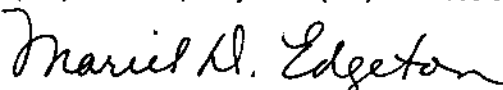
Management has recently reconsidered the policy of using cash discounts to determine the bid price for evaluation and selection of the lowest bidder. Since the State may not be able to take advantage of discounts offered when payment occurs beyond the time for the discount, it is inappropriate to select the bidder by using the discount to adjust the bid price.

Effective on **May 1, 1997**, all new solicitations issued by the Procurement Division will include a statement indicating that the bid evaluation will NOT consider cash discounts in determining the lowest responsible bidder meeting specifications. However, the State encourages bidders to offer cash discounts as part of their cash management strategy and the State should take advantage of such discounts incorporated into Purchase Orders/Contracts in accordance with the terms offered, whenever possible.

Buyers **MAY** choose to amend solicitations which have been issued prior to May 1, 1997, where bids have not yet been received in order to incorporate the revised policy, as the buyer wishes.

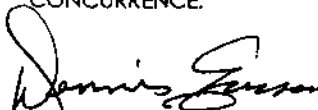
Notices should be included with the solicitations until the General Provisions are revised to incorporate this policy.

Questions may be referred to the managers named below. You can reach Mariel Edgeton at (916) 322-4789, or by fax to (916) 327-7593 or by cc:mail to medgeton@dgs.ca.gov



MARIEL D. EDGETON, Manager
Disputes Resolution and Training

CONCURRENCE:



DENNIS ERICSON, Manager
Major Acquisitions



BOB HOOVER, Manager
Food Procurement



TOM LEE, Manager
Commodity Procurement

PROCUREMENT DIVISION MISSION

"We ensure the success of our customer's mission by providing strategic acquisition and materiel management guidance while maintaining public trust."

STATE OF CALIFORNIA

STATE AND CONSUMER SERVICES AGENCY

Memorandum

DATE: May 7, 1997

TO: All Procurement Division Buying Personnel and Managers

FROM: Mariel D. Edgeton
Disputes Resolution and Training
Procurement Division
Department of General Services

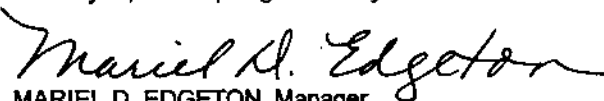
SUBJECT: **BID EVALUATION AND USE OF CASH DISCOUNTS**

My April 28, 1997 memorandum (same subject as above) which was concurred in by Dennis Ericson, Bob Hoover and Tom Lee, is hereby **CANCELED, EFFECTIVE IMMEDIATELY.**

Management will conduct further deliberations of how cash discounts in payment terms will be considered in bid evaluations. You will be notified of the results by a separate, written policy.

Questions may be referred to the managers named above or you can reach Mariel Edgeton at (916) 322-4789, or by fax to (916) 327-7593 or by cc:mail to medgeton@dgs.ca.gov

Thank you, and I apologize for any inconvenience.


MARIEL D. EDGETON, Manager
Disputes Resolution and Training

PROCUREMENT DIVISION MISSION

"We ensure the success of our customer's mission by providing strategic acquisition and materiel management guidance while maintaining public trust."

CASH DISCOUNT SURVEY

#3

The State of California is reevaluating its policy on the use of cash discounts offered by sellers of goods for payment of invoices within a designated time.

1. Do you consider cash discounts as a factor of award? Is it considered in your evaluations in order to determine the low bidder?
2. Is it addressed in either statute or formally adopted regulation?
3. If not calculated in your evaluations:
 - a. Do you state in your bid provisions that it will not be considered?
 - b. Do you still encourage your customer agencies to take advantage of any discount offered?
 - c. Is it not allowed because it would be predicated on a future and uncertain action or other reason?
 - d. Do you still provide for it on your bid forms?
4. If allowed:
 - a. Are there any limitations such as maximum percentages or minimum length of time?
 - b. Do you provide for it on your bid forms?

CASH DISCOUNTS CONSIDERED IN BID EVALUATIONS

<u>STATE</u>	<u>1.</u>	<u>2.</u>	<u>3a.</u>	<u>3b.</u>	<u>3c.</u>	<u>3d.</u>	<u>4a.</u>	<u>4b.</u>	<u>COMMENTS</u>
Arizona	yes	no					yes	yes	considered if 30 days or more
Oregon	yes	no					yes	yes	considered if 30 days or more
Utah	yes	no					yes	yes	considered if 30 days or more
Washington	yes	no					yes	yes	considered if 30 days or more

CASH DISCOUNTS NOT CONSIDERED IN BID EVALUATIONS

Florida	no	no	yes	yes	no	yes			Comptroller paid \$750,000 last year in late fees
Illinois	no	no	yes	yes	yes	yes			
New York	*	no	yes	yes	n/a	yes			*Tie bids only
Michigan	no	no	yes	yes	no	no			couldn't track so quit evaluating
Ohio	no	no	*	no	oth.	no			*bids state they will take 2%/10
Pennsylvania	no	law	yes	no	*	no			*not considered a firm price
Texas	no	no	yes	yes	no	yes			
Federal Government	no	reg	n/a	n/a	n/a	n/a	n/a	n/a	see attached FAR 52.232-8

SURVEY OF COUNTIES

QUESTION: In your county's evaluation of bids for commodities, do you use cash discount, also known as prompt payment discount, (net bid) in determining, for evaluation purposes, the lowest monetary bid?

<u>County</u>	<u>Answer/Comments</u>
County of Los Angeles Dave Lambertson 213/720-6810	Yes
County of Orange Michael Kolodisner 714/567-7304	Yes; however, if Department is unable to take advantage of the discount, it is ignored during evaluation.
County of Santa Cruz Andy Breda 408/454-2721	Yes, 30 days or more
County of San Joaquin Shari Habeeb 209/468-3250	Yes, 30 days or more
County of Ventura Tom Gill 805/654-3757	Yes, 30 days or more
County of San Diego Bill Napier 619/694-2916	Yes, 30 days or more
County of Sacramento Jim Marx 875-3037	Yes, 30 days or more on large purchases; on smaller purchases, department is contacted to see if cash discount can be taken advantage of

#4

Author: Patricia Jones at PD-HQ
Date: 8/8/97 4:31 PM
Priority: Normal
Receipt Requested
TO: Joyce Gibson at PD-HQ
CC: Mariel Edgeton at PD-HQ
CC: Jim Knibb at PD-HQ
CC: Bob Hoover at PD-HQ
CC: Dennis Ericson at PD-HQ
CC: Tom Lee at PD-HQ
Subject: Re: Discount Computations

----- Message Contents -----

8/8

Joyce

sorry I can't give you an answer, but the decision is not mine to make. Jim Knibb was going to arrange for a meeting of Mariel, Chuck, himself, Bob Hoover, Tom Lee and Dennis to resolve the issue.

I can tell you that, if we are proposing to NOT accept and evaluate such discounts, I don't believe we can discontinue our current practice until we have published our proposed practice, and give suppliers (and possibly others) an opportunity to voice their concerns.

So, it would seem that for the time being, our current practice should continue....

Pj

----- Reply Separator -----

Subject: Discount Computations
Author: Joyce Gibson at PD-HQ
Date: 8/8/97 2:34 PM

Pat,

I hope you're enjoying your vacation and not spending too much time on work stuff.

I'm in the last stages of the General Provisions rewrite, and there's one more thing I need to have cleared up. Are we going to adopt Mariel's proposed changes to bid evaluations regarding the application of discounts? She told me to check with you.

Joyce

Prompt Payment Discounts

8/15

Chuck, Tom, Dennis, Bob, Jim Knibbs

Jim passed out research of states / fed. gov't

Chuck - eliminate them! Need to communicate & get input before we implement.

Managers to provide supplier names to Jim

Gen provisions / PIN change - Ben
(advised Joyce Gibson aware of proposed language)

Need to inform deleg. holders

10/15 implementation w/ Price Analysis procedure

DEPARTMENT OF GENERAL SERVICES
PROCUREMENT DIVISION
BOX 942804
SACRAMENTO, CA 94204-0001



August , 1997

The Procurement Division is reevaluating its policy of considering cash discounts for payment of invoices within a designated time in our evaluation of proposals from sellers of materials, equipment, and supplies. We would like your opinion on whether we should continue to calculate this factor in our evaluations.

A number of other states, as well as the federal government, do not consider cash discounts such as 2%-30 days in their evaluations to determine low bids. Their reasons are existing prompt payment provisions, similar to California's Government Code Section 926.15, et seq., provide sufficient incentive to pay invoices on time and the occasional abuse of taking discounts even though they are not paid (or routinely unable to pay) within the time stipulated. In addition, it has been thought by some that cash discounts should not be considered in evaluations because they are predicated on future and uncertain actions.

Any change in our policy would not be meant to discourage bidders from offering such discounts or dissuade state agencies from taking advantage of any cost reduction policy such as this. We would just not consider them in our proposal evaluations.

Your input on this policy determination would be of great value to us. If you have any comments to make on this issue please forward them to _____. Thank you for your interest.

(A similar memo would be sent to selected state agencies.)

DEPARTMENT OF GENERAL SERVICES
PROCUREMENT DIVISION
BOX 942804
SACRAMENTO, CA 94204-0001



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(A similar memo would be sent to selected state agencies.)



State of California • Department of General Services • Pete Wilson, Governor
PROCUREMENT DIVISION
1823 14th Street, Room 100 • Sacramento, California 95814 • (916) 445-6942

April 28, 1998

Gary S. Webb
Consultant
Joint Legislative Task Force on Government Oversight
1020 N Street, Suite 420
Sacramento, CA 95814


Dear Mr. Webb:

This letter is in response to your request of April 23, 1998 requesting access to public records related to our policy regarding prompt payment and cash discounts. The following is a summary of the records we have for each of the specific points included in your letter:

1. All documents pertaining to our policy regarding the use of cash discounts for bid evaluation purposes. No cost-benefit analysis was done.
2. The cash discount survey that was sent to suppliers and all responses to that survey.
3. The cash discount survey that was sent to selected state agencies. Minimal response was received.
4. No minutes and/or memoranda exist for any meetings with any potential or current state suppliers regarding this issue.

Please contact Jim Knibb of my staff at (916) 324-6458, here at 1823 14th Street, if you wish to examine these documents.

Sincerely,


C. F. GRADY, Deputy Director
Department of General Services
Procurement Division
(916) 445-6942

CFG:JK:ras

cc: Jeanne Cain, Legislative Secretary, Office of the Governor
Karen Morgan, Deputy Legislative Secretary, Office of the Governor
Happy Chastain, Deputy Secretary-Legislation, State and Consumer Services Agency
Karen L. Neuwald, Asst. Director-Legislation, Dept. of General Services

Memorandum

Date: September 23, 1997

To: James Knibb
Department of General Services
Procurement Division
Systems Integrity Unit

From: Business Services Bureau
(916) 262-1437/CALNET 469-1437
FAX (916) 262-1445

Subject: Prompt Payment Discount Evaluations

The Department of the Youth Authority encourages the Procurement Division to adopt a policy of **not** considering prompt payment discounts when evaluating suppliers bids/proposals.

It is the policy of this Department not to consider prompt payment discounts in the managing of our delegated purchasing activities. We subscribe to the thought that prompt payment discounts, "are predicated on future and uncertain actions" that may be beyond the Departments control. For example, if a competition is close and the award is made based on the prompt payment discount, and subsequent events (paperwork not processed on time, cash-flow problems) render the Department unable to take advantage of the discount, and the second suppliers bid then becomes the low bid, the Departments integrity may become suspect. Therefor, the prompt payment discount should not be used as an evaluation criteria.


Mary Wandschneider, Chief

THE SEASIDE WORKS CENTER HAS PROMPT PAY DISC

MEMORANDUM

DATE: October , 1997

TO: Office of Procurement Personnel and Delegation Holders

FROM: Patrica Jones
Department of General Services
Procurement Division
System Integrity Unit

SUBJECT: Prompt Payment Discount Evaluations

Effective October 15, 1997, Procurement Division will change its policy of computing quick payment discounts and including them in our evaluation of bids/proposals from sellers of materials, equipment, supplies, and information technology goods and services. Buyers and Analysts will include the following language in all solicitations:

"Cash discounts offered by bidders for the prompt payment of invoices will not be calculated into the state's evaluation to determine the lowest bid or proposal. State agencies will continue to utilize any cash discount offered for quick payments, however, they will not be considered in evaluations."

The terms and conditions accompanying Invitations to Bid and Price Requests will be changed to reflect this new policy.

Any change in our policy would not be meant to discourage bidders from offering such discounts or dissuade state agencies from taking advantage of any cost reduction policy such as this. We would just not consider them in our proposal evaluations to determine the low bidder.

PROCUREMENT DIVISION MISSION

"We ensure the success of our customer's mission by providing strategic acquisition and materiel management guidance while maintaining public trust."



#10

Tom Lee

"We want you as a customer for life."

P.O. Box 1000
Elk Grove, CA 95759
9501 Stockton / Hwy 99
Elk Grove, CA 95624

688-8521
From Sacramento 423-2111

C. F. Grady
Deputy Director
DGS/Procurement Division
1823 14th Street / 95814
Box 942804
Sacramento, Ca. 94204-0001

December 8, 1997

SUBJECT: State's Revised Bidding & Payment Procedure

Mr. Grady:

We have recently received a number of Bid Invitations from the State of California noting the elimination of cash discounts for bid evaluations and the States terms of payment.

We (I) have been involved with State of California Contracts for many years and have found that the cash discounts offered by bidders is a very fair procedure as it provides for prompt payment in many situations. It is a procedure to reduce cost to the State. We (as a dealer) have to pay flooring on the vehicles sold to you; by eliminating this procedure in your evaluation of quotes we (the dealer) have to anticipate more/increased flooring costs on these vehicles and will have to pass those costs on to you the purchaser.

In conjunction with this, you now state that normal payment terms are sixty (60) days from date of invoicing and/or receipt of materials; unless the delivering party is a non profit organization with contract value of less than \$500,000, or a certified small business. This procedure appears to chastise 'Normal' retail merchants (even if our flooring institution would permit this 60 day float period).

As has been indicated, we do not agree with your revised procedure and request that it be reviewed with reinstatement of the previous program.

Sincerely,

Ron Brewer,
Fleet Manager

#11

DOWNTOWN FORD

525 NO 16TH STREET • SACRAMENTO CA 95814 • 442-6931



Tom -
Let's discuss -
Today 12/9 -
Chuck

Friday, December 05, 1997

Charles Grady
State of California
1823 14th Street
Sacramento, CA 95814

Dear Mr. Grady:

We recently received an Invitation for Bid for Used Subcompact Sedans, upon examination of the bid we noticed some changes in the "General Provisions" portion of the invitation, more specifically the sections that refer to discounts and payments (par. 16 and 19).

Until now, awards were based upon the lowest net price after a discount. This discount not only rewarded the State and it's taxpayers for paying quickly it also allowed the bidder to factor into his cost the time value of money. By allowing up to 60 days to pay a bidder must assume that the State will use that time in paying.

When calculating a bid the time value of money becomes a sizable factor. Assume our bid of \$21219.00 in 1997 for the 630 Police Vehicles for the Highway Patrol. We offered a \$500.00 discount for payment within 20 days the cost of \$21219.00 for 20 days is \$103.14. If the State is allowed up to 60 days to pay this amount triples and is used in the calculations of our bid.

You could say "we could still offer a discount". If we were to offer a discount of \$500.00 for payment within 20 days (\$21219.00 less \$500.00 Net bid Price \$20719.00) and it were compared to another bidder who offered \$200.00 discount under the same terms and the others' bid were \$10.00 lower (\$21209.00 less \$200.00 Net bid Price \$21009.00) would the State issue the award to the lowest net bidder or the one who was \$10.00 lower?

If we pencil this out a bit further, use the 630 vehicles the CHP purchased last year and apply the aforementioned math, the State would have paid \$182,700.00 more for the same vehicles. In 1996 we delivered 680 units, in 1993 630 units, in 1992 812 units, in 91 930 units and in 1990 741 units, for a total of 4423 units to the CHP applying the same scenario brings \$1,282,670 in potential additional costs. This figure pales in comparison when all the other State agencies and cities and counties units are figured, which to date has been an additional 10,000 units or \$2,900,000.00 of our taxpayers money.

Mr. Grady you can play with the equations in a multitude of ways and come up with varying amounts. The bottom line is by allowing this new provision the State and her taxpayers are ultimately paying more. The State has demonstrated in the past, by the more than 14,000 cars we've delivered, she can take advantage of discount terms. Those agencies that missed discounts, including the CHP and other city and county, are less than one half of one percent.




"All Fords are created equal — Downtown Ford makes the difference"

I'm sure you can see the significance of this, not only to the California Highway Patrol, but all the purchases made by the State of California.

Please contact me within the next week if you have any questions or would like to discuss the matter in more depth.

Sincerely,



David L. Forbess
Fleet Manager

**JEEP CHRYSLER PLYMOUTH DODGE**

5100 Chiles Road • Davis, California 95616 • Phone (916) 757-3770 • Fax (916) 758-3143

December 11, 1997

VIA FAX 324-2009

C. F. Grady
Deputy Director
Dept. of General Services
Procurement Division
1823 - 14th Street
Sacramento, CA 95814

Dear Mr. Grady:

The changes in the State bid procedure that allows 60 days for payment certainly places a severe financial burden on small business owners that many may not be able to overcome. Almost all automobile dealers borrow money from major banks or a finance source to purchase and floor plan their new vehicles. In the case of our major lenders, we must pay off the vehicle within 30 days after the delivery of the vehicle to the State or the date we are paid whichever occurs first. These are unusual terms as under normal circumstances the dealer must pay the finance source within a maximum of seven days even if he has not received payment from the purchaser.

We believe that our dealerships are the low bidder and should receive the purchase order soon from several classes of vehicles from October's General Purpose bid. We projected our money cost based on the vehicles being paid in 20 days and if the State is planning to enforce the up to 60 day payment on the General Purpose bid, we need to meet with you prior to the award. Frankly, we do not have enough potential profit per unit to cover an additional 40 days of interest cost; therefore, the only way we would be able to perform is to ask our manufacturer to subsidize us for the additional unexpected interest cost.

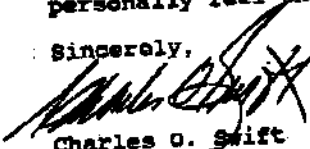
There is another bid for used vehicles (Invitation for Bid #42531) for 200 used vehicles that we had planned to bid; however, again because of the amount of the money involved, we would borrow money from our finance source and respectfully request that prior to the bid opening day, December 19, 1997, you consider allowing the discount offer and payment within 20 days on this particular bid. It certainly will affect the price we quote to the State.

Your Chrysler Franchised dealer for over 30 years

Mr. C. F. Grady
December 11, 1997
Page 2

Mr. Grady, as a bidder and businessman I do not understand at all the reasons for the change in policy as over the past 30 years, none of the State of California major purchasers of our vehicles on the General Purpose Bid, i.e. CHP, Cal Trans, Forestry, have not paid us within the 20 day period. Certainly the State of California if they need money can borrow it in the market place for a lot less than small business suppliers to the State. I personally feel that the ruling should be changed immediately!

Sincerely,



Charles O. Swift

COS/ke

cc: Dan Heil

#13

Author: Tom Lee at PD-HQ
Date: 11/10/97 10:56 AM
Priority: Normal
TO: Martin Stevenson <mstevens@trmx3.dot.ca.gov> at INTERNET_MAIL
CC: Rhonda Smith
CC: Patricia Jones
CC: George Hortin
CC: Mariel Edgeton
TO: Tom Lee
Subject: Re{2}: Recent DGS Changes to Prompt Payment Language on Bid
----- Message Contents -----

Another update. FYI, your Procurement & Contracts section was contacted for Caltrans' position regarding cash discounts. Doug Goto confirmed that Caltrans was in support of our new cash discount policy. .. Tom

Reply Separator

Subject: Re: Recent DGS Changes to Prompt Payment Language on Bid E
Author: Tom Lee at PD-HQ
Date: 11/5/97 6:01 PM

Martin, FYI there is a lot of research and discussion over this policy change. We are just not considering the cash discount for award purposes. Suppliers can still offer the discount for business purposes and we expect that they will continue to do so and you can continue to save the discount. What it cuts out is the gamesmanship used by bidders as a strategy to get awards. Now they will be giving us cash discounts that are good business practices and quote honest, straight up prices for items bid. In our research, we are the only big state to use the cash discount in evaluating bids. The feds, NY, Texas, Florida all do not use cash discounts in selecting their bids. They have found most discounts are not realized because of slow processes and we end up paying more than we should have. D&B research corroborates that in private industry discounts are rarely taken. So Chuck Grady approved a cash discount policy change that we in PD are exercising. .. Tom

Reply Separator

Subject: Recent DGS Changes to Prompt Payment Language on Bid Evalu
Author: Martin Stevenson <mstevens@trmx3.dot.ca.gov> at INTERNET_MAIL
Date: 11/5/97 3:10 PM

George,

I just finished reviewing the bid language for IFB 41952, our PE 22-W1075, PIN PE 49614. On the top of page 5 of the IFB is a paragraph which negates the old concept of including the prompt payment terms in the evaluation of offers from potential suppliers.

In the case of this purchase estimate, the impact of this change is significant. The estimated value of the purchase is \$2.1 million with an option to purchase more at the same price. By not including a prompt payment discount in the evaluation of offers, vendors who until now had offered a prompt payment discount of 5% would not have any reason to do so. 5% of \$2.1 million is 105,000, not including the exercise of any options. This move might be unfair to businesses who are forced to use lines of credit in the course of buying materials to fulfill the order.

would it be possible to delete this language for the above bid, or is this a new overall policy? If it is a new policy, has there been some study or audit which prompted the change? Was there some change in legislation or new regulations that were promulgated? Is there some change that would impact how we purchase on our delegated purchases?

For controller orders like this one, I am not aware of any significant problems with earning the prompt payment discounts. In fact, our warehouse aggressively earned over \$250,000 in discounts on a changeable message sign purchase order whose terms were 5% for payment in only 3 (three) days.

Using this language would be in the State's best interest in situations where the discount is unlikely to be earned. For road material purchases in certain large districts, this concept is one that I have long thought to be appropriate.

I look forward to hearing from you on this issue. If you have any questions or need additional information, please contact me at the address/numbers below. Thanks.

Martin Stevenson

Caltrans OPAC, 1900 Royal Oaks Drive, Sacramento, CA 95815

Internet E-mail: mstevens@trmx3.dot.ca.gov


Phone: (916) 445-7436, Calnet 8-485-7436 . . .

Fax: (916) 324-8997, Calnet 8-454-8997

#14

DATE: December 11, 1997

TO: Procurement Division Personnel

FROM:  PATRICIA A. JONES, Manager
Department of General Services
Procurement Division
System Integrity Unit

SUBJECT: Prompt Payment Discount Evaluations - MODIFICATION

In an effort to be responsive to our customer's requests, my memo of October 14, 1997 regarding prompt payment discounts is hereby modified. If an agency requests in writing to the Deputy Director that they would prefer that the prompt payment discount apply to a particular individual transaction, an exception may be made for that transaction.

If approved, the PIN phrases noted in my previous memo would not be used, but the solicitation will instead state the following:

PIN Phrase 273 (Agency Cash Discount)

For the purposes of this transaction, the State will consider any cash discount offered in the evaluation unless it is less than one-half of one percent, exceeds five percent, or is less than 20 days.

PROCUREMENT DIVISION MISSION

"We ensure the success of our customer's mission by providing strategic acquisition and material management guidance while maintaining public trust."

OF CALIFORNIA—DEPARTMENT OF MENTAL HEALTH

NAPA STATE HOSPITAL

100 NAPA VALLEJO HWY.
NAPA, CA 94558-6292
707/253-5000

January 6, 1998

Ron La Sala
Department of General Services - Procurement
1823 14th Street, Room 105
Sacramento, CA 95814

Dear Ron:

I would like to take exception to the new condition in the General Provisions that we can no longer use cash discounts in evaluating bids. As you are well aware, the State of California has had problems getting vendors to bid on the prime vendor contract because of our notoriously bad reputation for not paying our bills on time. The primary incentive in improving our reputation for prompt payment was the cash discount that you negotiated in the last prime vendor contract as well as your insistence that it be spelled out on every invoice. Now every accounting department knows how much money can be saved and most take full advantage of this.

It would be a shame to lose these hard earned gains and ultimately end up paying more because of the lack of competitive bids.

If I can be of further help, please feel free to contact me.

Sincerely,

Kevin C. Rockwood, Pharm.D., BCPP
Assistant Director of Pharmacy - Operations



#16
Department of Corrections

Memorandum

Date : January 7, 1998

To : Ronald W. La Sala
Associate Material Analyst
Department of General Services
Procurement Division

Subject : **BID EVALUATION CRITERIA**

This is in response to the information provided by you that the Department of General Services will no longer include cash discounts when evaluating competitive bids for services. This could adversely impact potential savings for the Department of Corrections (CDC) and the other agencies utilizing the Prime Vendor Contract for ordering drugs.

The current Prime Vendor Contract adds a service fee of 1% of the invoice total. However, if the agency pays within 20 days, the Prime Vendor gives a 1% cash discount. The net result is the elimination of the service fee and the avoidance of additional costs for the State. If future Prime Vendor Contracts are evaluated on the service fees alone a contract bid with a service fee of 2% and cash discount of 1% for early payment would be awarded over a contract bid with a service fee of 3% with a cash discount of 3%. This would result in a service fee payment of approximately \$250,000 per year for CDC regardless of how soon the invoice is paid.

The CDC is currently developing electronic payment of invoices through the regional accounting offices. This should further improve payment turnaround times and allow the Department to take advantage of cash discounts based on payment time.

For the reasons cited above, the CDC Health Care Services Division (HCSD) encourages the Department of General Services to continue utilizing cash discounts as a criterion for evaluating future contracts.

Thank you for your attention to this issue. If you have any further questions please don't hesitate to call Ronald R. Perez, Pharmacy Services Manager, at (916) 327-2025.

Nadim K. Khoury
NADIM K. KHOURY, M.D.
Assistant Deputy Director
Health Care Policy
Health Care Services Division

cc: Susann J. Steinberg, M.D., Deputy Director (A), HCSD
Sandra Duveneck, Assistant Deputy Director, Program Evaluation and Support, HCSD
Roger E. Hagen, Assistant Deputy Director, Health Care Operations, HCSD